IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 01.12.2006

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C.(A) Nos.2638 to 2643 and 2649 to 2654 of 2006

M/s.Bilahari Investments (P) Ltd.,
45, Poes Road, II Floor,
Chennai-18. .. Appellant in TC.[A] Nos.2638/2006 to 2643/2006.

M/s.Arabhi Investments [P] Ltd.,
46, Poes Road, I Floor,
Chennai 18. .. Appellant in TC.[A] Nos.2649/2006 to 2654/2006.

Vs.

The Commissioner of Income Tax,
Company Circle, Chennai. .. Respondent in all the appeals.

T.C. Appeals filed against the common order of the Income-tax Appellate Tribunal dated 26.5.2006 made in I.T.A. Nos.993/MDS/2002 to 995/MDS/2002, 1242/MDS/2002 to 1244/MDS/2002, 990/MDS/2002 TO 992/MDS/2002 and 1247/MDS/2002 to 1249/MDS/2002 for the Assessment Years 1996-97 to 1998-1999 against the Order of the Commissioner of Income Tax [Appeals] III, Chennai dt.22.3.2002 made in ITA.Nos.Tr.99/2001-02/A.III, Tr.178/2001-02/A.III, Tr.180/2001-02/A.III, Tr.172/2001-02/A.III and Tr.175/2001-02/A.III, against the order of the Asst. Commissioner of Income Tax, Company Circle IV[1] Chennai dt. 16.11.98 and made in PAN/GIR.539-B, 559-B, 559-A and 1272-A respectively.

For Appellants in all the cases : Mr.V.D.Gopal
For Respondent in all the cases : Mr.J.Narayanaswamy
Junior Standing Counsel

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COMMON JUDGMENT

(Delivered by P.D.DINAKARAN, J.)

These appeals arise out of the common order of the Income-tax Appellate Tribunal dated 26.5.2006 made in I.T.A. Nos.993 to 995, 1242 to 1244, 990 to 992 and 1247 to 1249/(Mds)/2002 for the assessment years 1996-97 to 1998-99 respectively.

2. The brief facts, which are common so far as the assesses are concerned, giving rise to the above appeals, are as under:-

2.1. The assessees are private limited companies subscribing to chits as their business activity. The assessees were maintaining its accounts on mercantile basis and computing loss or profit, as the case may be, at the end of the chit period in respect of chits terminating in a particular previous year, following completed contract method.

2.2. Before the assessing officer, the assessees claimed that the discount arose at a particular point of time when the prized chit amount was received and the discount was a statutory and contractual liability incurred by the subscriber as a consideration for obtaining the sum total of all the contributions by way of subscription in an accelerated manner. According to the assessees, the discount was not an amount paid in advance like rent or interest, but was a single amount giving rise to a single liability not only legally enforceable but also actually enforced by the Foreman by deducting it from the chit amount and by paying only the balance to the prized subscriber as the prized amount. The assessees further claimed that once the prized subscriber offered the highest bid, his liability for discount became crystallized, adjusted and totally discharged and the chit discount which was payable and adjusted against the bid amount leaving only the prized amount to be disbursed to the prized subscriber did not leave any scope for showing a part of the discount as an advance referable to the remaining period of the respective chit and it would be a misconception to call the discount amount as a time based liability and it would be legally untenable to dissect it on time basis. The assessees also contended that in mercantile system of accounting the liabilities were incurred irrespective of the date of payment whereas in the instant case, by virtue of the provisions of the Chit Funds Act and the agreement entered into between the Foreman and the assessees, the liability by way of discount arose in full measure at the moment the subscriber became a prized subscriber and it was a liability in praesenti and also a statutory liability which could not even be postponed by the act of the parties concerned.

2.3. The Assessing Officer found that the chit dividend was a regular activity and received on a regular basis and the discount amount would run for the remaining period of the chit. The assessing officer rejected

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the method of accounting adopted by the assessees and taxed the dividend in the year of receipt and allowed chit loss on proportionate time basis by distributing over the remaining period subsequent to the bidding at the chit auction.

2.4. On appeal by the assessees, the Commissioner of Income-tax (Appeals), while rejecting the completed contract method, held that dividend is taxable in the year of receipt and chit loss is allowable as a deduction in the year of bid itself.

2.5. Aggrieved against the same, both the assessees and the Department went on appeals before the Income-tax Appellate Tribunal and the Tribunal, relying upon the instructions made by the Central Board of Direct Taxes dated 16.5.76 and also relying upon the decision of the Apex Court in Madras Industrial Investment Corpn. Ltd. Vs. Commissioner of Income-tax (225 ITR 802), allowed the department's appeal and dismissed the appeals preferred by the assessees.

2.6. Hence, the assessees have preferred the present appeals raising the following common questions of law:

> a) Whether the Income tax Tribunal is right in law particularly in the light of S.5 and 145 of the Income tax Act, 1961, in rejecting the method of accounting adopted by the appellant under which income or loss as the case may be arises or accrues by netting dividend against chit loss, only at the end of the chit period of each chit group ?
>
> b) Whether the Income-tax Tribunal is right in law in applying the principles of deferred expenditure to the appellant's case where there is no deferred benefit and concluding that chit discount should be allowed spreading it over the remaining period of the chit on proportionate basis ?
>
> c) Whether the Income-tax Tribunal is right in law in not following the Central Board of Direct Taxes instruction dated 16.5.78 on the issue of taxability of dividend and allowance of chit loss as a deduction?

3. With regard to the issues raised in the above questions of law, this Court, in the assessees's own cases for the assessment years 1990-91, 1991-92, 1992-93 and 1993-94, in T.C.(A)Nos.76 to 86 of 2003 etc., batch, by common judgment dated 19.6.2006, held as follows:-

> "9.3. A conjoint reading of the above provisions of law makes it clear that all income received or deemed to be received or accrues or arises during the previous year shall form part of the total income of the assessee and such income shall be computed in accordance with the accounting system which the assessee is regularly following. Here, on the facts of the

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case, the authorities have found that the assessees are following mercantile system of accounting. The mercantile system of accounting means, as discussed in Shiva Prasad Gupta v. C.I.T. (AIR 1929 All. 823), the amounts that have become recoverable are shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed in any particular year. Therefore, when the assessees are following mercantile system of accounting, in which entries are posted in the books of account on the date of the transaction, that is, on the date on which rights accrue or liabilities are incurred irrespective of the date of payment, they have to account for their income or loss as per the mercantile system of accounting and not otherwise. Therefore, as rightly found by the Commissioner of income-tax (Appeals), the income derived during a particular previous year by way of chit dividend has to be reckoned and assessed as income of that year following the principles of mercantile/accrual system of accounting, particularly when the assessees are companies following the mercantile system of accounting.

10.1. The chit transaction is governed by the provisions of the Chit Funds Act. In view of the non obstante clause found in section 3 of the Chit Funds Act, 1982, namely,

> "3. Act to override other laws, memorandum, articles, etc.- Save as otherwise expressly provided in this Act,-
> (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force or in the memorandum or articles of association or bye-laws or in any agreement or resolution whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and
> (b) any provision contained in the memorandum, articles, bye-laws, agreement or resolution aforesaid, shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be",

the definitions of the expressions, discount, dividend, prize amount, as extracted above, will prevail over the similar definitions as found in the Income-tax Act, because a non obstante clause is generally appended to a section with a view to give the enacting part of the section in case of conflict, an overriding effect over the provision in the same or other Act mentioned in the non obstante clause (vide: State of Bihar v. Bihar Rajya M.S.E.S.K.K.Mahasangh (2005) 9 SCC 129). Therefore the discount is not an interest payable on the prized amount, but it is a loss.

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10.2. As already observed, in chit transaction there is no correlation between the discount amount and the future instalments. Further, the measure of future instalments does not depend upon the prized amount or the discount, nor the discount is an expenditure to be incurred in future. The discount is not a deferred expenditure for which payment has been made, or a liability incurred, but the discount is carried forward on the presumption that it will be of benefit over a specific period. In the chit transaction, there is no deferred benefit, which is construed to mean the benefit deferred to a year subsequent to the accounting year and hence, the question of deferred expenditure does not arise.

10.3. That apart, the provisions of the Chit Funds Act require the prized subscriber to furnish security for future instalments. Therefore, neither the enforceability of the right to receive the dividend, nor that of the obligation to pay the discount could be deferred and both accrued instantaneously. Hence, the discount is allowable in the very same year of accrual. In this view of the matter, the dividend has to be taxed in the year of accrual; so also, the discount has to be allowed in full in the year of accrual itself. The Appellate Tribunal is right in rejecting the completed contract method of accounting adopted by the assessees and at the same time, it is not correct in holding that the discount should be allowed spreading it over the remaining period of the chit on a proportionate basis.

11.1. For the foregoing reasons, we hold that the dividend income has to be taxed on the basis of its accrual and accordingly, we answer the first question in favour of the Revenue and against the assessee.

11.2. As regards the second question, we hold that the the discount loss claimed should be allowed in the year of its accrual and hence, we answer the second question in favour of the assessee and against the Revenue.

11.3. With regard to the third question, since the question is academic in nature, we need not go into the same.

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In view of the above, the above Tax Case Appeals are disposed of answering the first question of law in favour of the Revenue and against the assessee and the second question of law against the Revenue and in favour of the assessee. The third question being academic in nature is not answered. No costs.

Sd/-
Asst. Registrar.

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Sub Asst. Registrar.

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To
1.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "A", Rajaji Bhavan,
Besant Nagar, Chennai 90.
2.The Commissioner of Income-
Tax (Appeals) III, Chennai.
3.The Deputy Commissioner
of Income-tax, Company Circle
IV (1), Chennai.
4. The Assistant Commissioner of Income Tax,
Company circle IV [1], Chennai.
5. The Additional Commissioner of Income Tax,
Company Range I, Chennai.
6. The Commissioner of Income Tax,
Chennai I, Chennai.
+ 2 CCs to Mr.V.D.Gopal, Advocate SR NO 59265, 59266
+ 2 CCs to Mrs. Pushya Sitaraman, Sr. Standing Counsel for Income Tax, SR NO 59136, 59137

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mdr[co]
Gp/22.12.

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